PUBLIC COPY - REDACTED *CONFIDENTIAL PER 47 C.F.R. §0.457(d)*

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554

FILED/ACCEPTED

NOV 22 2010

Federal Communications Commission
Office of the Secretary

In the Matter of)
) WC DOCKET No 08-71
East Ascension Telephone Company LLC and)
EATELCORP, INC.) CC Docket No. 96-45
)
Appeal from a Decision of the Universal)
Service Administrative Company Concerning)
Follow-up Audit Number: HC-2009-FL068)

To: The Secretary
Federal Communications Commission

Attn: Wireline Competition Bureau

APPEAL OF USAC DECISION

Kenneth E. Hardman
Attorney At Law
2154 Wisconsin Avenue, NW
Suite 250
Washington, DC 20007
Direct Dial: (202) 223-3772
Facsimile: (202) 315-3587
kenhardman@att.net

Attorney for Appellants

November 16, 2010

TABLE OF CONTENTS

Summary of Appeal

USAC erroneously disallowed Interest and Income Tax expenses from the service rate charged by EATELCORP for management and "back office" services provided to EATEL. The rules mandate that such rates to be calculated using "fully distributed costs" (47 C.F.R. §32.27(c)(3)), and require only that EATELCORP not include more than a "reasonable share" of joint and common costs (47 C.F.R. §64.901(c)). EATELCORP used [Redacted] as the allocating basis for its costs, in accordance with 47 C.F.R. §32.2(b). That USAC or KPMG may prefer a different method for developing fully distributed costs does not make EATELCORP's method unreasonable or unlawful.

The principle that Interest and Income Tax expenses are proper components of fully distributed costs can be illustrated by assuming that a CLEC were to complain that EATEL is unfairly underpricing its ILEC services. In that case EATELCORP unquestionably could not exclude its interest and income tax expenses from the fully distributed cost of services it provides to EATEL, and likewise reasonably cannot exclude such costs from its service rate in this case. The rules require that EATELCORP price its services to EATEL on an arm's length basis, and that is what it did.

USAC's contention that Interest and Income Tax expenses must be piece parted out of EATELCORP's service rate and separately recorded directly to those specific accounts on EATEL's books is undermined by the accounting treatment afforded the other methods of developing affiliate rates for services. Service rates reflecting tariff rates, contract rates, prevailing price or fair market value are recorded in lump sum directly on the relevant accounts of the regulated company – they are not piece parted into components and recorded separately in the component accounts of the regulated company. The same accounting treatment thus is dictated for rates developed on the basis of fully distributed costs, a conclusion buttressed by the fact that EATELCORP's methodology also has been approved in a 2009 focus review by NECA. USAC's contrary position that the Interest and Income Tax components of EATELCORP's service rate must be piece parted out and recorded separately on EATEL's books of account is wholly unsupported by the rules and should be rejected.

EATELCORP's method of allocating software and maintenance fee expenses, which includes a detailed analysis of the directly attributable costs, should be approved. KPMG conceded that EATELCORP's method "has merit," but declined to change its finding on the grounds that the necessary information "was not made available;" and USAC affirmed the finding without explanation. Appellants respectfully disagree that the proper information was not made available, but request in any event that their allocation methodology be reviewed by the Commission and approved as fully satisfying Section 64.901(b)(3)(i) of the rules.

Finally, EATELCORP's documentation in support of its cost study reclassification and adjustments for 2005 should be approved. Exhibit C to the appeal is an explanation of their rationale for the reclassification and adjustment of cost items, which they undertook in order to comply with the dictates of 47 C.F.R. §§32.2(b) and 32.5999(a)(2) that the relevant costs be derived from functions performed by individuals. Closer analysis of those functions is how EATELCORP determined that adjustments properly should be made for Account 6724 (Information Management Expense), 6124 (General Purposes Computers Expense), 6620 (Commercial Operations) and 6533 (Testing Expenses); and its adjustments for 2005 accordingly should be allowed.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, DC 20554

In the Matter of	)	WC DOCKET NO 08-71
	)	
East Ascension Telephone Company LLC and	)	
EATELCORP, INC.	)	~~CC Docket~~ No. 96-45
	)	
Appeal from a Decision of the Universal	)	
Service Administrative Company Concerning	)	
Follow-up Audit Number: HC-2009-FL068	)	

To: The Secretary
Federal Communications Commission

Attn: Wireline Competition Bureau

APPEAL OF USAC DECISION

EAST ASCENSION TELEPHONE COMPANY LLC (EATEL) and its parent EATEL-CORP, INC. (EATELCORP) (collectively the "Appellants"), by their attorney and pursuant to Sections 54.719(c), 54.721 and 54.722 of the Commission's rules,[1] respectfully appeal in part, as hereinafter set forth, the decision dated September 28, 2010 of the High Cost and Low Income Committee (HCLIC) of the Universal Service Administrative Company (USAC), concerning the performance audit conducted by KPMG LLP (KPMG) for the Universal Service Fund disbursements made to EATEL during the twelve-month period ended June 30, 2007.[2] The audit, in turn, examined the costs recorded by EATEL during 2004 and 2005, which were the basis for certain USF disbursements to EATEL during the year ended June 30, 2007. The KPMG final report

[1] 47 C.F.R. §§54.719(c), 54,721, and 54,722.
[2] East Ascension Telephone Company Follow-up Audit Number: HC-2009-FL068 (SAC Number: 270429)

dated June 30, 2010 is attached as Appendix A: and the USAC decision on the report dated September 28, 2010 is attached as Appendix B.

<u>Introduction and Background</u>

The performance audit was undertaken to evaluate compliance by EATEL with applicable Commission rules and associated decisions governing Universal Service Support (47 C.F.R. Part 54, Subparts C, D and K), Jurisdictional Separations (47 C.F.R. Part 36, Subpart F) and the Uniform System of Accounts (47 C.F.R. Part 32, Subpart B). The audit was made in connection with USF disbursements of [Redacted] to EATEL during the 12 months ended June 30, 2007, based upon certain costs recorded by EATEL during 2004 and 2005.

KPMG made nine findings and related recommendations as a result of its audit, which are summarized at Appendix A, pp. 3-5. With the exception of KPMG Finding 2, USAC upheld KPMG's findings, despite objections and explanatory information provided by EATEL in response to KPMG's contentions. *See* Appendix B at pp. 2-5. As a result, based upon KPMG's audit and USAC's determinations, USAC asserts that it is entitled to recover [Redacted] of the High Cost support USF disbursements to EATEL for the year ended June 30, 2007. *Id.* at p. 5.

EATEL and EATELCORP do not challenge the majority of KPMG's and USAC's findings and conclusions. However, they categorically appeal Finding No. 1, disallowing EATELCORP's inclusion of interest and income tax expenses in developing the fully distributed cost of leased labor provided by EATELCORP to EATEL for management and "back office" functions of customer services, information technology, accounting, engineering and marketing. *See* Appendix A at pp. 12-17. Additionally, they appeal in limited part Finding No. 3 to the extent it would require software and maintenance fee expenses to be allocated between regulated and non-regulated lines of business simply on the basis of direct payroll expenses, rather than the on the basis of the cost causative apportionment factor developed by EATELCORP. *See* Appendix A at pp. 19-22. They also appeal in limited part Finding No. 5 to the extent it finds that the documentation they provided is inadequate to support their cost study reclassifications and adjustments for certain G/L Accounts in 2004 and 2005. *See* Appendix A at pp. 24-25.

Argument

1. Interest and Income Tax Expenses Properly Are Elements of Fully Distributed Costs of Overhead and Back Office Services Provided by EATELCORP to EATEL and Should Not Have Been Disallowed by USAC

USAC concurs with KPMG's Finding No. 1 that fees charged by EATELCORP for various management and "back office" functions provided by employees of EATELCORP to EATEL for regulated services improperly included components for income tax and interest expenses incurred by EATELCORP. Although not completely clear, USAC apparently also concurs with KPMG's criticism that EATELCORP used an allocation factor that was calculated in a prior year and not appropriately updated. Appellants respectfully submit that USAC is incorrect on both counts, as explained below, and should be reversed.

At the outset, Appellants submit that USAC and KPMG have incorrectly characterized the nature of the affiliate transaction in question and have misapplied the applicable rules. The affiliate transactions in question are management and "back office" services provided by the parent EATELCORP exclusively to its regulated affiliate EATEL and to other, generally unregulated, affiliated companies in the EATEL family as well. The rule governing the rates for such services is that portion of Section 32.27(c)(3) that states: "All services received by a carrier [*i.e.*, EATEL] from its affiliate(s) that exist solely to provide services to its members of the carrier's corporate family [*i.e.*, EATELCORP] *shall be recorded at fully distributed costs.*" (Emphasis added).

At the same time, the exact expenses included in or excluded from "fully distributed costs" for purposes of Universal Service disbursements, and the appropriate methods for developing such costs, are not detailed in the Commission's rules or other authoritative guidance. Instead, the rules state generally that "Services included in the definition of universal service *shall bear no more than a reasonable share* of the joint and common costs of facilities used to provide those services. 47 C.F.R. §64.901(c). (Emphasis added).

The governing legal standard, therefore, is whether EATELCORP included more than a "reasonable share" of its joint and common costs in the service rate it charged for management and other "back office" services it provided to EATEL. The fact that KPMG or USAC may believe that there is a preferable method for developing fully distributed costs is decidedly beside the point. Rather, the pertinent point is that in the absence of definitive contrary guidance to which USAC and KPMG can point, EATELCORP's methodology for developing its fully distributed costs for its services plainly is reasonable and therefore lawful.

KPMG's and USAC's position rests entirely on the erroneous proposition that interest and income tax expenses incurred by a parent may not be considered proper cost components when developing fully distributed costs. In this regard, it should be remembered that the underlying purpose of requiring fully distributed costing for regulated services in the first place is to promote fair competition between regulated and unregulated companies.[3]

If this case instead involved a CLEC complaint alleging that EATEL is unfairly underpricing its ILEC service offerings, there is no question whatsoever that EATELCORP would be prohibited from excluding its interest and income tax expenses as cost components of the rate

[3] *See, e.g.,* Accounting Safeguards Under the Telecommunications Act of 1996 (*Notice of Proposed Rulemaking)* (the "*Accounting Safeguards NPRM"),* CC Docket No. 96-150, 11 FCC Rcd 9054, at ¶¶3-4 (FCC 1996) (accounting safeguards mandated by 1996 Act are intended to "foster the development of robust competition in all telecommunications markets" as part of "rules for fair competition in the markets that are opened to competitive entry").

charged for management and other "back office" services provided to EATEL. The principle involved in such a case is exactly the same as involved here – only the context is different. But resolution of the *principle* involved should be the same in both cases, *i.e.,* income tax and interest expenses properly should be included as fully distributed cost components in the service rate in both cases.

The basic flaw in USAC's and KPMG's analysis is that they are confusing the issue of *allocation* of costs from a parent to a subsidiary with a *service* cost charged by an affiliate. In paragraph 78 of the *Accounting Safeguards NPRM, supra,* the FCC discusses the general implementation of "arm's length transaction" requirement for affiliate transactions established in Section 272 (b) (5) of The Telecommunications Act of 1996.[4] The concept that affiliate transactions properly should be treated as arms' length transactions is well documented in the governing statute and rules.[5]

Furthermore, the concept that EATEL is charging a rate developed for its services, as opposed to simply allocating costs, is clearly explained in the RAO Letter 26, *supra,* which details that various rates for affiliate services include (1) a tariffed rate; (2) a rate pursuant to a publicly-filed agreement; (3) the prevailing price; (4) the fair market value; (5) the fully distributed cost. A fully distributed costing methodology apportions the total costs of a group of services or products -- including the authorized interstate rate of return -- among the individual services or products in that group. The resulting cost apportionments determine the share of total cost that is attributed to each service or product. *Id.*

[4] 47 U.S.C. §272(b)(5).
[5] *See generally, e.g.,* The Telecommunications Act of 1996, 47 U.S.C. §§260, 271-276; Accounting Safeguards Under the Telecommunications Act of 1996*(Report and Order)* (*Accounting Safeguards R&O*), CC Docket No. 96-150, 11 FCC Rcd 17539 (FCC 1996) (subsequent history omitted); Responsible Accounting Officer Letter 26 *(Transactions With Affiliates)* (RAO Letter 26), DA 98-855, 13 FCC Rcd 9368 (Accounting Safeguards Div. 1998); and NECA Cost Guidelines.

The service rate aspect is further supported in the *Accounting Safeguards R&O, supra,* and RAO Letter 26, which specifically authorize a rate-of-return element to the calculation of fully distributed cost. The inclusion of a rate-of-return element demonstrates that the concept of "fully distributed cost" in the context of services provided exclusively to affiliated companies refers to a developed *service* cost and not a simple *allocation* of costs.

EATELCORP charges the costs of its services to all of its subsidiaries, including EATEL, and those service charges are developed in the same manner for all subsidiaries, including EATEL. EATELCORP has determined that the fully distributed cost of its services to affiliates includes the following expenses:

- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]

Since the primary costs charged to the subsidiaries are labor and the associated employment costs ([Redacted] of the total fully distributed costs), EATELCORP uses [Redacted] as the allocating basis for its costs. The use of [Redacted] as an allocator is supported by 47 C.F.R. §32.2(b), which states that "the primary bases of plant operations, customer operations and corporate operations expense accounts are the functions *performed by* individuals." (Emphasis added).

The "overhead" factors (*i.e.,* the leased labor factors as described at p. 9 of Appendix A) actually calculated by EATELCORP using its methodology for 2004 and 2005 were [Redacted] and [Redacted], respectively. By rounding down the calculated factor to [Redacted] for its regulated affiliate, EATELCORP actually charged slightly *less* than its fully distributed costs, thereby – and contrary to USAC's and KPMG's conclusion -- effectively *understating* the costs submitted for universal service support recovery.

It is also relevant to emphasize that USAC's and KPMG's assertion that interest expense and income taxes are "incorrect cost components" in the calculation of a fully distributed cost-based service rate is unsupported. That is, USAC and KPMG simply assert their position, but have not and cannot point to any definitive authority or guidance to support their position.

As with most of its allocation rules, the Commission provides a framework that can be applied to widely varying company circumstances. This flexible attribute is referred to in 47 C.F.R. §32.2(c) where the Commission states "because of the variety and continual changing of various cost allocation mechanisms, the financial accounts of a company should not reflect an *a priori* allocation of revenues, investments or expenses to products or services, jurisdictions or organizational structures." Neither USAC nor KPMG provides a specific rule or other authoritative guidance that EATELCORP allegedly is violating in including interest expense and income taxes. Nor can they do so because there is no support for their assertion.

Interest Expense and Income Expense amounts are properly included in the development of the service rate from EATELCORP to its affiliates. Indeed, the idea that components of corporate expenses from affiliated transactions should be recorded in the regulated company books in the same accounts (*i.e.,* Interest expense from the parent should be recorded as interest expense on the regulated company books) is not only incorrect, but also, upon analysis, puzzling as well.

The *Accounting Safeguards R&O, supra,* and the affiliate transaction rules[6] provide the differing valuation methods of costs to provide services in various affiliate transactions. However, the way those service costs are *recorded* on the books of the affiliate remains the same regardless of the particular valuation method used. That is, under the principles established by these requirements, whether the service charges to an affiliate are based upon tariffed rates, contract rates, prevailing price rates, or fair market value, the service charges derived from those rates are all charged directly to the relevant expense accounts of the affiliate receiving the services, in exactly the same manner as all other other charges for services received from independent third-parties.

For example, if this case instead involved long distance telephone service provided by EATELCORP to EATEL at standard tariff or contract rates, the entire amount of charges for such services would be recorded by EATEL in lump sum directly to its telephone service expense accounts. EATEL would *not* piece part out the components of the tariff or contract rate that constituted EATELCORP's interest and income tax expenses and record those components in EATEL's interest and income tax expense accounts. So, here, EATEL properly recorded service charges by EATELCORP for management and "back office" services in lump sum directly to their relevant accounts on EATEL's books, and properly did not – as USAC and KPMG incorrectly would have it do – piece part the service rate into components and make separate entries for different components of the service rate.

In summary, the rules do *not* make a distinction in the manner in which different affiliate transactions are to be recorded by the recipient; instead, all of these different types of service expenses – whether charged at tariff rates, contract rates, prevailing price or fair market value -- are charged directly to the relevant expense accounts of the recipient company. Service rates based

[6] 47 C.F.R. §32.27

on fully distributed costs likewise are treated no differently under the rules and should be recorded in the same fashion. Based on the authoritative guidance of Section 32.27 of the rules, therefore, EATEL respectfully submits that it properly records the service rate charged by its affiliate directly to the relevant expense accounts of its books.

The second issue regarding the amount of income tax expense included is similar to the first, in that EATELCORP is not in fact making a simple allocation of the parent company expenses. Rather, the company is charging a rate for services provided to its affiliates. The inclusion of imputed income taxes as a cost component of that rate follows Section 32.27(e) of the rules, which states: "Income taxes shall be allocated among the regulated activities of the carrier, its nonregulated divisions, and members of an affiliated group." Section 32.27(e) properly allows EATELCORP to use an allocated amount of income taxes in the development of the service rate, which is exactly what it has done.

The suggestion implicit in USAC's and KPMG's position, *i.e.,* that only the actual income taxes recorded on the books are taken into consideration for rate development or recovery of costs, is fundamentally in error. In fact, the amount of income tax expense allowed in such calculations varies by rule and method of recovery. For example, the following cost recovery methods allow these amounts for income tax expense:

- For ICLS, income tax expense is imputed at federal rate of 34% for C-corporations or the effective tax rate of shareholders for S-corporations with a further imputed state tax amount at the actual state tax rate applied to the separated return on rate base.
- For LSS, income tax expense is imputed at federal rate of 35%.
- For HCL, actual income tax expense recorded is used for C-corporations or for S-corporations an imputed amount is calculated at the effective tax rate of shareholders.
- For tariffed rates, income tax expense is also imputed at a federal rate of 35%.

Thus, USAC's and KPMG's premise that only the actual recorded income tax expense can be used in the calculation of fully distributed cost is belied by the differing cost recovery methods for income taxes allowed in other contexts, and by the specific application of Section 32.27(e) of the rules.

USAC and KPMG attempt to justify their position by pointing to the second sentence of Section 32.27(e), which states:

> Under circumstances in which income taxes are determined on a consolidated basis by the carrier and other members of the affiliated group, the income tax expense to be recorded by the carrier shall be the same as would result if determined for the carrier separately for all time periods, except that the tax effect of carry-back and carry-forward operating losses, investment tax credits, or other tax credits generated by operations of the carrier shall be recorded by the carrier during the period in which applied in settlement of the taxes otherwise attributable to any member, or combination of members, of the affiliated group.

How USAC and KPMG jump from that premise to their conclusion (that income taxes must be directly recorded by the carrier) is wholly unexplained, and certainly is not apparent from the text of the rule provision. On its face the provision simply addresses the treatment of income taxes expenses that are already acknowledged to be expenses properly recorded on the direct expense accounts of the carrier; and in essence the rule says that the allocation should not result in a charge that is more than if the carrier incurred the tax directly.

But that rule does not speak at all to the issue of *when* income tax expenses should be recorded directly on the books of the carrier, or *which* income tax expenses should be so recorded. Thus, USAC's and KPMG's analysis of Section 32.27(e) does no more than beg the question at issue here and should be rejected.

Similarly fallacious is USAC's and KPMG's attempt to find support for their position in the general requirements of Section 64.901 of the rules.[7] Once again they simply quote what

[7] 47 C.F.R. §64.901.

they deem to be pertinent sections of the rules without providing any illumination as to why they think the quoted sections support their position.

The first flaw in their analysis, of course, is that the Part 64.900 series (Subpart I of Part 64) applies to the allocation of costs, *i.e.*, the "separat[ion of] , , , regulated costs from nonregulated costs". 47 C.F.R. §64.901(a). *That* function – the separation of regulated costs from non-regulated costs – takes place *before* the function at issue here. That is, EATEL has already *separated* its regulated costs from its non-regulated costs when it proceeds to calculate its fully distributed service rate for EATEL and other subsidiaries. Thus, Part 64.900 really does not even address the issue here, much less resolve it.

USAC and KPMG point to the general requirement of §64.901(a) that carriers should use "the attributable cost allocation for such purpose" when separating their regulated costs from non-regulated costs. But that is *exactly* what EATELCORP did! As noted by USAC and KPMG, Section 64.901(b) goes on to require that whenever possible, "common cost categories are to be allocated based upon *direct analysis of the origin of the costs themselves.*" (Emphasis added). EATELCORP has explained above that it first directly analyzed the origins of its management and other "back office" costs, and then computes its service rate for its affiliates on the basis of fully distributed costs, including the specific elements of labor, employee benefits, other employment expenses, depreciation, interest, income taxes and a return on investment. USAC and KPMG do not trouble to explain why EATELCORP's procedure does not fully comply with Section 64.901(b); rather, they simply misread the rule by substituting the phrase "direct *assignment* of the costs" for the rule's actual requirement of "direct *analysis* of the origin of the costs". (Emphasis added).

Lastly, Appellants point out that the service rate calculation used by EATELCORP has been reviewed by the National Exchange Carrier Association (NECA). NECA reviewed the calculation as part of a focus review of EATEL's affiliate transactions and non-regulated cost assignments conducted in the summer of 2009. NECA concluded that EATELCORP's accounting treatment was proper, thus undermining USAC's and KPMG's unsupported claims to the contrary.

2. <u>EATELCORP's Method of Allocating Software and Maintenance Fee Expenses Should Be Approved</u>

KPMG's Finding No. 3 contends that certain EATELCORP software and maintenance expenses for seven vendors were incorrectly assigned directly to the regulated operations of EATEL. KPMG determined that these expenses instead should have been allocated between the regulated and nonregulated businesses and activities; and it developed an allocation factor for that purpose based upon a ratio of direct payroll costs. On the basis of its allocation methodology, KPMG claimed that a total of [Redacted] in USF high cost disbursements should be recovered for the year ended June 30, 2007. *See* Appendix A at pp. 19-21.

At USAC, Appellants did not challenge KPMG's general determination that these expenses should have been allocated between their regulated and unregulated lines of business. Rather, Appellants argued that the payroll allocation method used by KPMG is not appropriate, and they provided their own methodology to use in determining how these expenses should be allocated between EATEL and its affiliates, thereby more accurately measuring the directly attributed costs incurred by EATEL for software and maintenance services. *See* Appendix A at pp. 21-22.

KPMG conceded that EATELCORP's methodology "has merit" but declined to change its finding, asserting that "information on the other cost causative allocators for joint/common expenses was not made available." *Id.* at p. 22. USAC affirmed KPMG's finding without explanation. *See* Appendix B at pp. 2-3.

The governing legal standard is Section 64.901(b)(3)(i) of the rules, which states that "Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the cost themselves." Again, that is exactly what EATELCORP did in developing an allocation factor based upon expenses incurred in performing billing, plant/loop assignment, trouble, inventory, job order/CPRs, Service Activation Processing (SAP), workflow and time entry functions. *See id.* at pp. 21-22. As noted above, KMPG has acknowledged that EATELCORP's allocation methodology "has merit".

Appellants respectfully submit that no useful purpose would be served by a debate over whether they timely provided support for their allocation methodology to KPMG during the audit. Appellants believe they did, but that is beside the point. Rather, the pertinent point is that EATELCORP's allocation methodology fully satisfies the governing standard of Section 64.901(b)(3)(i) of the rules. Therefore, EATELCORP's allocation methodology should be used to determine the amount of any recovery of USF disbursements as a result of this audit, and to allocate its software and maintenance costs on a going forward basis. Accordingly, Appellants request that the Commission direct USAC and KPMG to reconsider and recalculate the USF recovery for software and maintenance expenses on the basis of EATELCORP's allocation methodology.

3. EATELCORP's Documentation in Support of its Cost Study <u>Reclassifications and Adjustments for 2005 Should Be Approved</u>

Finally, in Finding No. 5, KPMG determined that Appellants provided inadequate documentation under Part 32 of the Commission's rules to support their cost study reclassifications and adjustments for certain General Ledger accounts in 2004 and 2005. *See* Appendix A at pp.

25-25. At USAC, Appellants did not challenge KPMG's finding with respect to 2004, but disagreed with its finding for 2005. *See id.* at p. 26. Without further explanation, USAC concurred with KPMG, while recognizing that EATEL "is committed to addressing its internal controls related to this finding," and determined that USF High Cost disbursements in the amount of [Redacted] should be recovered for the two years. *See* Appendix B at pp. 2-3, 5.

Again, Appellants are not here challenging KPMG's or USAC's findings in this regard for 2004, but they respectfully submit that the documentation they provided for 2005 adequately complies with the requirements of Part 32 of the rules and should be approved. Contrary to KPMG's and USAC's finding, for 2005 Appellants did in fact provide support – including allocation methodologies used, exhibits shown, and rationale used – for the cost study adjustment that was made.[8] In addition, Appellants relied on Sections 32.2(a), 32.2(b) 32.2(e), 32.5999(a)(2) and 32.5999(a)(4) of the rules in determining the cost study adjustment necessary to more appropriately "functionalize" the cost originally coded to Account 6724 (Information Management Expense).

In this regard, Section 32.2(b) of the rules states in relevant part that "the primary bases of plant operations, customer operations and corporate operates expense accounts are the functions *performed by* individuals". (Emphasis in original). Further, Section 32.5999(a)(2) of the rules goes on to explain that "Expenses to be recorded in the Customer Operations and Corporate Operations accounts reflect the costs of, or are associated with, functions performed by people, irrespective of the organization in which any particular function is performed."

During the audit Appellants noted that several departments inadvertently were not charging time of the department personnel to the systems they supported, which is the correction made by the cost study adjustment. For example, Appellants noted that a time study performed in

[8] See Appendix C.

2004 properly justifies that their Data Center supports multiple functions, of which some of the costs associated with those functions were incorrectly recorded to Account 6724 (Information Management Expense) when they properly should have been recorded to Account 6124 (General Purposes Computers Expense).

Appellants further pointed out that expenses coded to Account 6724 support Customer Care and trouble information systems, which more accurately should be coded to Account 6620 (Commercial Operations) and 6533 (Testing Expense), respectively. Expenses incorrectly booked to Account 6724 also support Inventory and Procurement activities, thus making a cost study adjustment for this function necessary.

The spreadsheet attached as Appendix C reflects the documentation for the reclassifications and adjustments that are targeted in KPMG's Finding No. 5. Given the foregoing justifications and documentation, Appellants respectfully request that their cost study reclassifications and adjustments for 2005 be allowed as initially entered.

Conclusion

For the reasons stated above, EATEL and EATELCORP respectfully submit that USAC and KPMG erred in disallowing EATELCORP's interest and income tax expenses as components of the service rate charged by EATELCORP for management and "back office" services provided to EATEL during 2004 and 2005, and accordingly request that USAC's decision disallowing those components be reversed and remanded to KPMG to recalculate EATEL's USF disbursements based upon the fully distributed costing methodology employed by EATELCORP for its service rates for 2004 and 2005. EATEL and EATELCORP further respectfully submit that USAC and KPMG erred by declining to allocate software and maintenance expenses between regulated and nonregulated business on the basis of the allocation factors developed by

EATELCORP during the audit, and accordingly request that USAC's decision be reversed and remanded to KPMG with instructions to calculate allocation factors based upon EATELCORP's methodology. Finally, EATEL and EATELCORP respectfully submit that USAC and KPMG erred by disallowing EATELCORP's cost study reclassifications and adjustments for 2005, and accordingly request that USAC's decision be reversed and that the reclassifications and adjustments for 2005 be allowed in full.

Respectfully submitted,

East Ascension Telephone Company LLC
EATELCORP, INC.

By: s/Kenneth E. Hardman
Kenneth E. Hardman
2154 Wisconsin Avenue, NW, Ste 250
Washington, DC 20007
Telephone: (202) 223-3772
Facsimile: (202) 315-3587
kenhardman@att.net

Their Attorney

November 16, 2010

A P P E N D I X   A

PUBLIC COPY -- REDACTED

APPENDIX B

PUBLIC COPY -- REDACTED

APPENDIX C

PUBLIC COPY -- REDACTED

Abdel-Hamid.Eqab

\\server\name

PSCRIPT Page Separator